Nos. 34 and 37

In the Supreme Court of the United States

OCTOBER TERM, 1939

ESTATE OF CHARLES HENRY SANFORD, DECEASED, JENNIE R. BAIRD, SUBSTITUTIONARY ADMINISTRATRIX, C. T. A., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ALMON G. RASQUIN, COLLECTOR OF INTERNAL REVENUE OF THE UNITED STATES FOR THE FIRST DISTRICT OF NEW YORK, PETITIONER

v.

GEORGE ARENTS HUMPHREYS

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURTS OF APPEALS FOR THE THIRD AND SECOND CIRCUITS, RESPECTIVELY

BRIEF FOR THE RESPONDENT IN NO. 34 AND FOR THE PETITIONER IN NO. 37

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OPINIONS BELOW

Sanford Estate case. The memorandum opinion of the United States Board of Tax Appeals (R. 33–35) is unreported. The opinion of the Circuit

Court of Appeals (R. 173–177) is reported in 103 F. (2d) 81.

Humphreys case. The District Court rendered no opinion. The *per curiam* opinion of the Circuit Court of Appeals (R. 28) is reported in 101 F. (2d) 1012.

JURISDICTION

Sanford Estate case. The judgment of the Circuit Court of Appeals was entered March 25, 1939 (R. 178). Petition for a writ of certiorari was filed April 17, 1939, and was granted May 15, 1939 (R. 178–179). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Humphreys case. The judgment of the Circuit Court of Appeals was entered February 10, 1939 (R. 28–29). The petition for a writ of certiorari was filed April 27, 1939, and was granted May 22, 1939 (R. 29). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Both cases involve *inter vivos* trusts in which the donor retained no right to revoke the trust or to revest title to the corpus in himself, but reserved the right to modify the trust deed and change the beneficiaries in any manner not increasing his own beneficial interest in the trust estate. The single question presented in both cases is whether, under the gift tax provisions of the Revenue Acts of

1924 and 1932, the taxable transfer occurs (1) at the time when the donor relinquishes all beneficial interest in the trust property, even though retaining the power to modify the trust deed and change the beneficiaries, or (2) at the time when the power of modification and change is relinquished.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations will be found in the Appendix, *infra*, pp. 51–58.

STATEMENT

1. Sanford Estate case

The facts in this case as stipulated (R. 10–33, 46–173) and found by the Board of Tax Appeals (R. 33–35) may be summarized as follows:

On December 24, 1913, Charles Henry Sanford, a resident of New Jersey, transferred certain securities to the Guaranty Trust Co. of New York as trustee (R. 11, 46–54). The original trust indenture (R. 46–54) provided that the trustee should hold the trust property subject to the payment of an indebtedness of the grantor to the Trust Company, and also provided for the payment of certain annuities out of income (R. 47–48). The trustee was directed to set apart $150,000 in securities in trust for a great-grandson (R. 48) and to divide the remainder of the property into five equal shares in trust for the benefit of each of five grandchildren, with provision for the disposition of each share on the death

of each grandchild.[1] The grantor reserved the right to augment the corpus of the trusts and the right to terminate or modify any or all of them by a suitable instrument in writing filed with the trustee (R. 51–52).

Several supplemental indentures modifying the trusts were executed by the decedent (R. 46), but no change was made in the power reserved to the grantor to terminate or modify the trusts until November 26, 1919 (R. 90–92). On that date the grantor executed a supplemental indenture changing this reserved power to read as follows (R. 91):

> The party of the first part, however, reserves the right to modify any or all of the trusts herein created by suitable instruments in writing executed under his hand and seal and duly acknowledged as a deed of real estate is required to be acknowledged under the laws of the State of New York, and filed with the party of the second part; but this right of modification, however, shall in no way be deemed or construed to include any right or privilege in the party of the first part to withdraw principal or income from any trust created by this instrument.

On August 21, 1924, the remaining power of modification reserved to the grantor was relin-

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[1] The beneficiaries of two of the trusts predeceased the grantor and the property reverted to the grantor, who added it to the other trusts (R. 65–75, 99–128).

quished pursuant to the following provisions of another supplemental indenture (R. 171):

> The party of the first part hereby renounces all rights to further modify the terms of the said trusts or any of them and does hereby surrender all such rights reserved to him by the indenture of December 24th, 1913, and by the various indentures supplemental thereto.

Sanford did not file a gift tax return for 1924 (R. 34). He died in 1928 and the administrator of his estate, after a revenue agent had raised the question as to whether the surrender in 1924 of the power to modify the trusts subjected the transfer to a gift tax at that time, filed a gift tax return with the Collector of Internal Revenue for the District of New Jersey (R. 34). The property held by the trustee on August 21, 1924, was listed in the return, but the administrator, on behalf of the estate, disclaimed any liability for the tax (R. 34). The aggregate value of the property held in the trusts as of that date was $6,846,225.06 (R. 11).

Conferences were thereafter held between representatives of the taxpayer and representatives of the Government (R. 12). A tentative ruling of the Bureau of Internal Revenue held that the gifts were made in 1924, when the power of modification was relinquished, and hence were subject to tax under the gift tax provisions of the Revenue Act of 1924 (R. 21–28). A later ruling held that the trans-

fers became effective on November 26, 1919, when the grantor relinquished his right to terminate the trusts or to modify them in such a way as to enable him to withdraw principal or income, and that since the gifts were completed before any gift tax law became effective, they were not subject to any gift tax (R. 14–21, 34). This ruling was approved by the Under Secretary of the Treasury (R. 32–33, 34), and the petitioner was notified on April 19, 1935, that the gift tax return for 1924 disclosed no tax liability and the case had been marked closed (R. 29, 34). However, the ruling was revoked by the Bureau after the decision of the Circuit Court of Appeals for the Second Circuit in the case of *Hesslein* v. *Hoey,* 91 F. (2d) 954, certiorari denied, 302 U. S. 756, and on October 16, 1937, the Commissioner mailed a notice of a deficiency in the amount of $1,000,745 (R. 6, 29–32, 33–34).

Joseph McDermott, as administrator *cum testamento annexo* of Sanford's estate, filed a petition for review in the Board of Tax Appeals (R. 2). McDermott died June 10, 1938, and Jennie R. Baird was duly appointed to succeed him. By order of the Circuit Court of Appeals dated September 2, 1938, Jennie R. Baird was substituted as the petitioner in that court.

The Board of Tax Appeals sustained the determination of the Commissioner, holding that the transfers were subject to the gift tax imposed by the Revenue Act of 1924. The Circuit Court of Appeals affirmed that decision.

2. Humphreys case

This action was instituted against the Collector of Internal Revenue for the refund of a gift tax paid for 1934 (R. 6–8). The plaintiff, who is the respondent in this Court, filed a motion for summary judgment pursuant to Rule 113 of the New York Rules of Civil Practice (R. 4–6). The District Court granted the motion (R. 2–3) and entered judgment for the plaintiff in the sum of $11,181.14, plus interest and costs (R. 3–4). The Circuit Court of Appeals affirmed the judgment of the District Court (R. 28–29).

The essential facts appear in the complaint (R. 6–8) and the exhibits attached thereto (R. 8–26) as follows:

On December 27, 1934, the respondent, a resident of New York, executed a trust indenture conveying certain property to George Arents, Jr., Harold W. Brooks, and United States Trust Company of New York, in trust for certain uses and purposes (R. 6, 8–20, Ex. A). The trustees were directed to receive, hold, manage, sell, invest, and reinvest the corpus of the trust, to collect the income thereof, and, after deducting expenses of the trust, to pay over the net income to the settlor during his life (R. 9). Upon the settlor's death, one-half of the then corpus was to be paid to George Arents, Jr., or his issue (R. 9). In the event that Harold W. Brooks survived the settlor, the remaining one-half of the corpus was to be held in

trust and the annual net income therefrom paid to Brooks until the death of Brooks or of George Arents III, whichever should first occur, whereupon that trust was to terminate and the corpus be paid to the survivor of them (R. 9). If Brooks did not survive, this half of the corpus was to be paid over to George Arents III absolutely (R. 9). The indenture contained alternative provisions for the disposition of the corpus to others in the event that those designated to receive it did not survive (R. 9–10).

Paragraph Seventh of the indenture provided as follows (R. 12–13):

> This trust is hereby declared to be irrevocable and it shall not at any time, by any person or persons, be capable of modification in any manner, except that the Settlor reserves the right, without the consent of the Trustees or of any beneficiary hereunder, at any time and from time to time during his life, by an instrument or instruments in writing under his hand and duly acknowledged so as to authorize it or them to be recorded in the State of New York, to alter and amend this Trust Deed to the extent of substituting for the beneficiaries named herein other beneficiaries and to prescribe the terms and conditions on which such other beneficiaries shall take an interest in the trust, but the Settlor shall not by any such alteration or amendment increase his personal beneficial interest in the trust estate.

On March 12, 1935, the respondent filed with the petitioner a gift tax return for the calendar year 1934 (R. 6–7, 20–22, Ex. B), in which he reported the value of the remainder interests conveyed under this indenture as a taxable gift in the amount of $263,201.71. The tax due thereon in the amount of $11,181.14 was paid to the petitioner on March 12, 1935 (R. 7).

On February 17, 1938, the respondent filed a claim for refund of the amount paid (R. 7, 23–25, Ex. C) based on the allegation that the transfer pursuant to the trust indenture did not constitute a gift taxable under the gift tax provisions of the Revenue Act of 1932. On March 11, 1938, the claim was rejected (R. 8, 25–26, Ex. D), whereupon this suit was instituted.

When respondent's motion for summary judgment was filed, petitioner's counsel filed no papers in opposition. He stated to the court that the case was apparently controlled by *Hesslein* v. *Hoey*, 91 F. (2d) 954 (C. C. A. 2d), but that the Commissioner had not acquiesced in that decision (R. 2–3). In granting the motion for summary judgment and entering judgment for the respondent, the District Court rendered no opinion. On appeal the court below affirmed, *per curiam*, on the authority of *Hesslein* v. *Hoey*.

SPECIFICATION OF ERRORS TO BE URGED IN THE HUMPHREYS CASE

The Circuit Court of Appeals erred:

1. In holding that the transfer in trust, by the terms of which the settlor reserved the power to alter or amend the trust deed by substituting other beneficiaries for the beneficiaries named and to prescribe the terms and conditions on which such other beneficiaries shall take an interest in the trust but without the power to increase his personal beneficial interest in the trust estate, is not such a transfer as is subject to tax under the gift tax provisions of the Revenue Act of 1932, as amended; and in failing to hold that the transfer in trust is subject to tax under the gift tax provisions of the Revenue Act of 1932, as amended.

2. In affirming the judgment of the District Court.

SUMMARY OF ARGUMENT

The two cases at bar present a single question of statutory interpretation, namely, whether, in the case of an *inter vivos* transfer in trust, a "gift" subject to taxation under the gift tax law is made (1) when the donor relinquishes all beneficial interest in the property even though reserving a power to modify the trust and change the beneficiaries, or (2) when such reserved power of modification and change is relinquished.

The Government believes that almost equally cogent arguments may be advanced in support of either view. Therefore, to protect its interests

pending an authoritative decision by this Court, the Government has necessarily been forced to take inconsistent positions in different cases. In the *Sanford Estate* case it has taken the position that relinquishment of the power of modification constitutes the taxable gift, while in the *Humphreys* case it has taken the position that relinquishment of the donor's beneficial interest in the property, irrespective of the reservation of a power of modification, constitutes the taxable gift. A decision favorable to the Government in either case will necessarily preclude a favorable decision in the other.

Because of a genuine doubt as to the proper interpretation of the statute and because we do not believe that a decision either way will have a predictable effect upon Federal revenues, we do not feel justified in urging upon the Court adoption of either view to the exclusion of the other. Consequently, we will set forth in this brief all of the arguments which we believe may legitimately be made for each position.

I

The view that the gift tax should be imposed when the donor relinquishes power to revest title in himself is based on the theory that a completed gift has been made by the donor as soon as he ceases to have any beneficial interest in the property, even though there is no completed gift to any particular donee or donees. This view is sup-

ported by the language of the Revenue Act, which imposes a tax upon "the transfer * * * by gift * * * of any property," rather than a tax upon the receipt of property. Moreover, since the donor is the one primarily liable for the tax, it seems most consistent with the philosophy of the tax to levy it when the transfer of property rights by him is complete and to base the amount of the tax upon the then value of the trust estate. *Burnet* v. *Guggenheim,* 288 U. S. 280, insofar as it stresses as the taxable event the divestment by the donor of his beneficial interest in the trust estate, lends support to this view.

The Treasury Regulations applicable to the cases at bar, while they do not specifically cover the present situation, contain the implication that the tax is to be imposed when the grantor relinquishes his beneficial interest in the property rather than when he relinquishes his power of modification. They were so interpreted in *Hesslein* v. *Hoey,* 91 F. (2d) 954 (C. C. A. 2d), although the court refused to follow them because they were of comparatively recent adoption. If the regulations are to be interpreted as directing imposition of the tax when the grantor completes the transfer of his property rights, even though reserving a power of modification as to the donees, there is persuasive reason for believing that they should be considered as accurately reflecting the legislative intention, since the regulations promulgated under the gift tax provisions of the Revenue Act of 1924 were subsequently

incorporated into the Revenue Act of 1932 as Section 501 (c). See *Burnet* v. *Guggenheim, supra.*

Hesslein v. *Hoey, supra,* is direct authority against the view supported in this portion of the brief. That decision was based upon the premise that the gift and estate taxes were intended to be correlative and that since the termination by death of a power of modification effects a transfer subject to the estate tax (*Porter* v. *Commissioner,* 288 U. S. 436), the termination of such a power by the donor during his life should be deemed to be the taxable event for purposes of the gift tax. While there is force in this position, fundamental differences between the estate and gift taxes may not be overlooked. *Porter* v. *Commissioner* was based squarely on the express provisions of Section 302 (d) of the Revenue Act, which specifically subjects to the estate tax the termination by death of a power of modification; the gift tax statute contains no similar provision. The inference may logically be drawn that had Congress desired to impose a gift tax upon the surrender of a power of modification, just as the estate tax is imposed upon the termination of such power by death, it would not have left its intention equivocal, but would have inserted in the gift tax statute provisions analogous to those embodied in the estate tax law.

No question of double taxation would be involved in a holding that the gift tax attaches to the creation of a trust in which a power of modification is reserved, even though the subsequent termination

by death of the reserved power is subject to an estate tax, since Congress has specifically provided that the gift tax shall be credited against the estate tax. That Congress deemed it necessary to provide for this credit is an indication that it did not intend the two taxes to be entirely correlative.

II

The view that the gift tax should be imposed only when the donor surrenders his power of modification is based on the theory that a gift requires a donee as well as a donor and cannot be said to be complete until the donor has fully exercised his right to choose the objects of his bounty. The control which the donor retains over the ultimate disposition of the trust estate is susceptible of such exercise as to afford him considerable economic benefit from the property and gives him an interest in the trust estate which in its effect is closely akin to a property right. Until this interest is transferred by relinquishment of the reserved power, the transfer in trust may logically be deemed an imperfect gift.

Porter v. *Commissioner, supra,* lends support to this view. In that case this Court, construing Section 302 (d) of the estate tax as imposing a tax upon the termination by death of a reserved power of modification, held the section to be valid as applied to trusts created before there was any provision in the estate tax law subjecting them to tax.

If the transfers by the donor had been deemed complete when made, the tax could not have been applied retroactively. *Helvering* v. *Helmholz*, 296 U. S. 93.

In *Burnet* v. *Guggenheim, supra,* this Court indicated its opinion that the gift and estate taxes were intended to be correlative. Since the termination of a reserved power of modification is subject to the estate tax upon the death of the grantor, *Burnet* v. *Guggenheim* is persuasive authority that termination of such power by the donor during his life is the taxable event for purposes of the gift tax. The Circuit Court of Appeals for the Second Circuit expressly so held in *Hesslein* v. *Hoey, supra,* a decision specifically based upon the premise that the two transfer taxes were designed as correlative. This premise is amply supported by the legislative history of the gift tax statutes.

The correlation argument is bolstered by the fact that Section 510 of the gift tax law imposes a secondary liability upon the donees for payment of the tax. If, as the Circuit Court of Appeals held in the *Hesslein* case, imposition of the tax at the creation of the trust means that the named beneficiaries are secondarily liable for the tax under Section 510 even though they may subsequently be deprived of all interest in the property, an incongruous situation would be created. Moreover, if a gift tax is imposed on a transfer in trust before the donor has irrevocably chosen the beneficiaries,

it would result in taxing an otherwise exempt charitable gift if the donor should ultimately decide to change the named beneficiaries and substitute a charity.

ARGUMENT

Introductory statement

The two cases at bar present a single question of statutory interpretation, namely, whether, in the case of an *inter vivos* transfer in trust, a "gift" subject to tax under the gift tax law is made (1) when the donor relinquishes all personal beneficial interest in the property even though reserving a power to modify the trust and change the beneficiaries, or (2) when such reserved power of modification and change is relinquished.

The Government believes that almost equally cogent arguments may be advanced in support of either view. Therefore, to protect its interests pending an authoritative decision by this Court, the Government has necessarily been forced to take inconsistent positions in different cases. In the *Sanford Estate* case, the Government has taken the position that the relinquishment of a power to modify a trust constitutes a taxable gift even though, at the time of such relinquishment, the donor had no power to revoke the trust or to increase his own beneficial interest therein. In the *Humphreys* case, on the other hand, the Government has taken the position that the creation of a trust whereby the grantor irrevocably parts with

all beneficial interest in the trust estate constitutes a taxable gift despite a reservation in the grantor of a broad power of modification. A decision favorable to the Government in either case will necessarily preclude a favorable decision in the other.

Because of a genuine doubt as to the proper interpretation of the statute and because we do not believe that a decision either way will have any predictable effect upon the aggregate amount of Federal revenues, we do not feel that the Government would be justified in urging upon the Court the adoption of either view to the exclusion of the other. Consequently, we will set forth in this brief all of the arguments which we believe may legitimately be made for each position.

Presentation of the arguments in favor of the Government's position in each of the cases will be facilitated by first considering the precise nature of the issue and the applicability to that issue of the three principal cases bearing on the problem—*Burnet* v. *Guggenheim,* 288 U. S. 280; *Porter* v. *Commissioner,* 288 U. S. 436; and *Hesslein* v. *Hoey,* 91 F. (2d) 954 (C. C. A. 2d), certiorari denied, 302 U. S. 756.

There is and can be no dispute that Congress has the power to levy a gift tax either upon the creation of a trust in which the grantor reserves a power of modification, or upon the relinquishment of that reserved power. Both acts cause "a change

of legal rights and a shifting of economic benefits" which Congress may tax as a transfer effected at that time. *Burnet* v. *Guggenheim, supra,* at 284-285. The question, therefore, is one of legislative intention and not of legislative power. Concededly, "Congress did not mean that the tax should be paid twice, or partly at one time and partly at another" (p. 285). If the creation of a trust with a reserved power of modification is a present transfer by gift within the meaning of the Congressional enactment, the relinquishment of the reserved power is not such a transfer. Decision, therefore, depends upon determination of which of the two donative acts Congress intended to tax.

A similar choice was presented in *Burnet* v. *Guggenheim, supra,* where the question was whether the creation of a revocable trust or the extinguishment of the power of revocation constituted the taxable transfer by gift. The opinion of this Court, holding that Congress intended to impose the tax upon extinguishment of the power, can be used as the basis of an argument on either side of the issue involved in the present cases. Insofar as it stresses as the taxable event the divestment by the donor of his beneficial interest in the trust estate, it tends to support the view that creation of the trust or relinquishment of the power of revocation constitutes the "gift" which Congress subjected to tax, irrespective of the existence of a

power of modification. Insofar, however, as the holding is predicated upon the conviction that Congress intended the gift and estate taxes to be correlative it supports the conclusion that the taxable event is the relinquishment of the power of modification. Under the federal estate tax law, the value of property transferred by a deed of trust reserving to the grantor a power of modification but no power to make a change in favor of himself or his estate is properly included in the gross estate of the grantor. *Porter* v. *Commissioner, supra.*

Significant differences between the provisions of the gift tax and of the estate tax may not be ignored in determining the weight to be given *Porter* v. *Commissioner* in decision of the present issue. That decision was based squarely on the express language of the estate tax law, which provides that the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property "To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke * * *." Section 302 (d). The gift tax statute contains no such provision, being imposed merely "upon the transfer * * * by gift * * *

of any property."[2] Unless, therefore, this Court holds as a matter of statutory construction that Congress intended the general language of the gift tax to be construed in the light of the specific language of the estate tax, the decision in *Porter* v. *Commissioner* is far from decisive of the present issue.

Certainly a decision in the present cases that relinquishment of the donor's beneficial interest in the trust property rather than relinquishment of his power of modification constitutes the taxable event would not be inconsistent with or throw any doubt upon the *Porter* case. As already stated, Congress could tax either act. In the case of the estate tax it has specifically indicated its intention to tax the transfer resulting from termination of the power of modification, while in the case of the gift tax its intention is left unexpressed. No inconsistency would be involved in holding that Congress intended the gift and estate taxes to be im-

[2] Revenue Act of 1924, Sec. 319. Section 501 (a) of the Revenue Act of 1932 imposes a tax "upon the transfer * * * of property by gift." Section 501 (b) provides that the tax shall apply whether the transfer is in trust or otherwise. Section 501 (c) provides that the tax shall not apply to the creation of a revocable trust but that the relinquishment or termination of the power of revocation, otherwise than by the donor's death, shall be considered a taxable gift. As is pointed out below, Section 501 (c) was repealed after the decision of this Court in *Burnet* v. *Guggenheim*, *supra*, on the ground that subdivision (c) added nothing to, but was merely declaratory of, the provisions of subdivision (a).

posed upon different types of transfers, nor, as pointed out below (*infra*, pp. 34–35), would such a holding result in any problem of double taxation.

The *Porter* case was relied upon by the Circuit Court of Appeals for the Second Circuit to reach its decision in *Hesslein* v. *Hoey*, *supra*, that the gift tax attaches to the relinquishment of a power of modification rather than to a transfer of the donor's beneficial interest in the trust property subject to such power of modification. The court, citing *Burnet* v. *Guggenheim* for the proposition that the gift and estate taxes are in *pari materia* and must be construed in conjunction, held that since the estate tax is imposed only when the power terminates by the death of the donor, termination of the power by the donor during his life must be the taxable event for purposes of the gift tax. Judge A. N. Hand dissented.

Both of the present cases were decided by the courts below on the authority of *Hesslein* v. *Hoey*.

I

THE ARGUMENT IN SUPPORT OF THE GOVERNMENT'S POSITION IN THE HUMPHREYS CASE THAT A TAXABLE GIFT IS MADE WHEN THE DONOR IRREVOCABLY TRANSFERS HIS BENEFICIAL INTEREST IN THE TRUST PROPERTY EVEN THOUGH RESERVING A POWER TO MODIFY THE TRUST DEED AND CHANGE THE BENEFICIARIES

The creation of a trust whereby the grantor gives up all beneficial interest in the trust estate is unquestionably a completed transfer of property rights from the standpoint of the donor. Whether

or not he reserves the power to modify the trust and change the beneficiaries, he has irrevocably given up all property interest in the *res* and all power to revest title in himself. Only from the viewpoint of the donee or donees is the transfer inchoate, since until the reserved power of modification is relinquished or terminates, there is no perfected gift to any particular beneficiaries and the ultimate beneficial takers must remain undetermined.

The language of the gift tax law affords persuasive reason for believing that the completion of the transfer from the donor rather than the completion of the gift to particular donees is the decisive factor. It is "the transfer * * * by gift * * * of any property" which is the subject of the tax, not the receipt of such property.[3] Unquestionably there was, in both cases at bar, a completed transfer of property when the power of revocation was relinquished. If the incidence of the tax is upon such a transfer rather than upon the receipt of the property by the ultimate beneficiaries, the fact is unimportant that the donor, by reserving the right to change the beneficiaries, had power completely to alter the disposition of the income and corpus of the estate.

This construction of the statute is supported by the fact that the donor is the one primarily liable for the tax. This would seem to indicate that the

[3] See footnote 2, page 20, *supra*.

irrevocable divestment of all of the donor's rights in the property, rather than the irrevocable vesting of rights in particular beneficiaries, should be the taxable event. Moreover, because the donor is the taxpayer, selection of the valuation date which most truly measures his donative intent would seem to be most consistent with the philosophy of the tax. When the donor relinquishes all possibility of personal profit from the property subject to the trust, he creates a situation where future fluctuations in the value of that property can have no bearing upon his economic situation. The amount of the gift he has given is the then value of the property placed in trust, and the tax which he must pay can accurately reflect what he has given only if based upon a valuation made at that time.

Burnet v. *Guggenheim, supra,* lends support to the conclusion that the gift is complete when the grantor surrenders the power to retake the property himself. In holding that the relinquishment of a power of revocation rather than the creation of a revocable trust effects the taxable transfer, this Court stressed the fact that the donor's reservation of the power to revoke the transfer made his gift "formal and unreal" and stated that "a gift is not consummate until put beyond recall (p. 286). This language may well be deemed to contain the negative indication that transfers, such as the ones here involved, which are beyond recall and which, therefore, have substance and reality from

the point of view of the donor, do constitute taxable gifts within the meaning of the statute.

If, as petitioner in the *Sanford Estate* case contends, the decision in the *Guggenheim* case stands for the broad proposition that termination of the donor's power of revocation is a taxable transfer by gift, irrespective of the reservation of any other type of power, the decision would be determinative of the *Sanford Estate* case in favor of the taxpayer and, consequently, determinative of the *Humphreys* case in favor of the Government. Sanford relinquished his power of revocation in 1919 before the enactment of the gift tax, and surrendered his remaining power of modification in 1924. If the *Guggenheim* decision means that any relinquishment of a power of revocation is a taxable gift, the Sanford gift was completed in 1919 and consequently his subsequent renunciation of the power of modification is not subject to tax. However, although this interpretation of the *Guggenheim* case finds considerable support in the language of the opinion, it seems doubtful that the decision may properly be considered as direct authority for any such broad proposition. The relinquishment of the power of revocation there discussed was not accompanied by any reservation of a power of modification and the Court had no occasion to consider the applicability of its decision to such a situation. See *Hesslein* v. *Hoey, supra.*

The Treasury Regulations applicable to the gift tax, while raising somewhat the same problem of

interpretation as that raised by the *Guggenheim* case, may, we believe, be construed as embodying the rule for which the taxpayer contends in the *Sanford Estate* case and as supporting the position of the Government in the *Humphreys* case. Article 1 of Regulations 67 (1924 ed.), promulgated under the Revenue Act of 1924, provides merely that the creation of a trust with a reserved power of revocation should not be deemed to constitute a taxable gift but that "a taxable transfer will be treated as taking place in the year in which such power is terminated." Article 3 of Regulations 79 (1933 ed.) promulgated under the Revenue Act of 1932, is to the same effect.[4] Article 3 of Regulations 79 (1936 ed.) promulgated under the Revenue Act of 1932, as amended by the Revenue Acts of 1934 and 1935, is, however, more specific. These regulations provide in part as follows:

> The tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. On the contrary, the tax is a primary and

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[4] These regulations provide in part as follows: "The relinquishment or termination, without an adequate and full consideration in money or money's worth, of the power to revest in the donor title to property transferred in trust, is a gift of such proper[illegible] [illegible] the time of the relinquishment or termination of the power, except where the power is terminated by the donor's death."

> personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable.
>
> As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to cause the beneficial title to be revested in himself, the gift is complete. But a transfer (in trust or otherwise), though passing both legal and beneficial title, is still in essence merely formal so long as there remains in the donor a power to cause the revesting of the beneficial title in himself, and the gift, from the standpoint of substance, remains incomplete during the existence of the power. * * * The relinquishment or termination of the power, occurring otherwise than by the death of the donor (the statute being confined to transfers by living donors), is regarded as the event which completes the gift and causes the tax to apply. * * *

Regulations 79 above quoted seem clearly to contemplate that the creation of an irrevocable trust or the relinquishment of a power of revocation constitutes a taxable gift irrespective of the reservation of a power of modification. And the same rule may fairly be implied from provisions of the earlier regulations which provide for the imposition of a tax upon the termination of a power of revocation without any exception in the case of a

reserved power of modification. The assumption seems warranted that if the Treasury Department deemed it necessary to promulgate a specific regulation that a transfer of property under a revocable trust was not taxable, it would have promulgated a similar regulation with respect to a trust in which the grantor reserved a power of modification if it had not considered that such a transfer was taxable. In any event, prior to the decision in *Hesslein* v. *Hoey,* the Bureau of Internal Revenue consistently took the position that the gift tax applied to a transfer in trust where the grantor reserved the right to modify the trust but no right to revest title in himself. Approximately 300 cases were disposed of by the Bureau on that theory, although the administrative practice was not embodied in any published rulings of the Bureau. It should also be noted that in *Hesslein* v. *Hoey,* the Circuit Court of Appeals construed Article 3 of Regulations 79 (1933 ed.) as providing for the imposition of a tax in a case where the donor reserved a power of modification but no power of revocation, although the court declined to follow the regulation on the ground that it was one of comparatively recent adoption. On the other hand, in the *Sanford Estate* case, the court below held that the regulation did not provide a determinative rule.

If the earlier regulations, which are the ones applicable to the cases at bar, should be construed as containing the negative implication that the reservation of a power of modification does not pre-

vent the creation of an irrevocable trust or the relinquishment of a power of revocation from being a taxable gift, there is persuasive reason for believing that they should be considered as accurately reflecting the legislative intention. The provisions of Article 1 of Regulations 67, which were promulgated under the 1924 Act and which are quoted above, were subsequently given express statutory sanction by being incorporated in substance into the Revenue Act of 1932 as Section 501 (c). See *Burnet* v. *Guggenheim*, *supra*, at p. 282, in which this Court held that the regulation and the 1932 statute continuing it were declaratory of the law which Congress meant to establish by the Revenue Act of 1924. While Section 501 (c) was repealed after the decision in the *Guggenheim* case by Section 511 of the Revenue Act of 1934, the repeal was only because "the principle expressed in that section is now a fundamental part of the law by virtue of the Supreme Court's decision in the *Guggenheim* Case."[8] Consequently, as a matter of Congressional interpretation, the gift tax Act must be read as though the provisions of Section 501 (c), and consequently the earlier Treasury regulation, were part of the law. See dissenting opinion of Judge A. N. Hand in *Hesslein* v. *Hoey*, *supra*.

The decision of the majority of the court in the *Hesslein* case, as we have pointed out above, is directly opposed to the view advanced in this por-

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[8] See H. Rep. No. 704, 73d Cong., 2d Sess., p. 40; S. Rep. No. 558, 73d Cong., 2d Sess., p. 50.

tion of the brief. See also *Rosenau* v. *Commissioner,* 37 B. T. A. 468. The principal basis of the *Hesslein* decision was the conviction that the estate tax and the gift tax were intended to be correlative and that since the termination by death of a power of modification effects a transfer subject to the estate tax (*Porter* v. *Commissioner, supra*), termination of such a power during the donor's life should be deemed to be the taxable event for purposes of the gift tax. That there is force in this position is undeniable. The considerations which support it are discussed in the second portion of this brief (*infra,* p. 38 *et seq.*).

But there are also persuasive reasons for believing that Congress did not intend the gift tax law to be construed in the light of the estate tax law. As has previously been stated, the gift tax law differs fundamentally from the estate tax law in that it does not enumerate the types of transfers which are intended to be within the ambit of its operation.[9] It may logically be inferred that had Congress desired to subject to the gift tax the same changes in legal rights and economic benefits which, when occurring at death, are specifically subjected to the estate tax, it would not have left its intention equivocal but would have inserted in the gift tax statute provisions similar to those embodied in the estate tax law. While this Court suggested in

[9] See subdivisions (b) to (g) of Section 302 of the Revenue Act of 1924 (c. 234, 43 Stat. 253) and of the Revenue Act of 1926 (c. 27, 44 Stat. 9). U. S. C., Title 26, Section 411.

Burnet v. *Guggenheim* that the concept of a transfer as developed in the estate tax law was not to be disregarded in construing the gift tax law, it nevertheless pointed out that differences in the precision of definition between the two laws could not be ignored.

Congress clearly contemplated that certain transfers, such as those made in contemplation of death, would be reached both by the gift and estate taxes, for it provided for the allowance of a credit against the estate tax for gift taxes.[7] That Congress deemed it necessary to provide for this credit shows that the two laws were not designed to operate so that imposition of a gift tax on a transfer would necessarily preclude imposition of an estate tax with respect to the same transfer, or *vice versa*, and indicates that to a certain extent at least each law was regarded as establishing its own criteria for the imposition of the tax.

Because of this provision for the allowance of a credit, no contention can be made that a decision favorable to the Government in the *Humphreys* case would result in double taxation. The transfer would be subjected to both taxes, but the amount paid as a gift tax would be credited against the estate tax.

The second ground upon which the majority of the court rested its decision in the *Hesslein* case

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[7] See Section 322 of the Revenue Act of 1924 (U. S. C., Title 26, Sec. 413) and Sections 402 (b) and 801 of the Revenue Act of 1932 (U. S. C., Title 26, Secs. 413 and 536).

was the fact that, by Section 510 of the Revenue Act of 1932, the donees of a gift are made secondarily liable for payment of the tax, the Court stating that it would be unreasonable to assume that Congress intended to impose such liability upon donees who might subsequently be deprived of all right to receive the trust property. The reasoning of the court is based upon a construction of Section 510, which is not entirely free from doubt. This section provides as follows:

> The tax imposed by this title shall be a lien upon all gifts made during the calendar year, for ten years from the time the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift.

While the foregoing language is far from clear, we question whether Congress intended that a beneficiary of a trust who had not received and might never receive any distribution from the trust should be required to pay the gift tax on the transfer in trust in the event that the donor failed to pay. We think it probable that Congress intended that in such event the trust estate should be made to respond for the tax in the first instance by enforcement of the statutory tax lien. If this be true, the provision with respect to the liability of the donee may properly be construed as imposing liability upon him only when the gift to him is completed. In this view, the meaning of the statute is

simply that the donee shall be personally liable for the tax to the extent of the value *to him* of the gift *to him.*

It seems reasonable to assume that if a gift is made in trust for a number of beneficiaries, no single beneficiary is liable, at least beyond the value of the gift to him, for the payment of the gift tax upon the entire transfer should the donor fail to pay. It is not the value of the gift *by the donor* which would seem to measure the extent of the donee's secondary liability under Section 510 but rather the value of the gift *to the donee.* This being so, it would be entirely consistent to hold that the donor is liable for the tax when the gift by him is completed but that the secondary liability of the donee attaches only when the gift to him is perfected and then only to the extent of his interest therein.

Even if this construction is unsound and the beneficiaries named in the trust deed are secondarily liable for the tax despite the grantor's reservation of a power of modification, it does not necessarily follow that undue hardship would be imposed on such beneficiaries. It might well be that, on common law principles, they would have a right of reimbursement from the trust estate or from the ultimate beneficial takers. Cf. *Phillips-Jones Corp.* v. *Parmley,* 302 U. S. 233. In any event, it seems somewhat strained to determine the legislative intent in the enactment of one ambiguous section of a law by considering the possible hardships which

a particular construction of that section might cause under one of several constructions of another ambiguous section of the law.

We believe the foregoing considerations constitute persuasive reason for a decision by this Court in favor of the Government in the *Humphreys* case and in favor of the taxpayer in the *Sanford Estate* case. On the other hand, the arguments presented in the succeeding section of this brief are, in our view, equally cogent in favor of a contrary ruling. Before proceeding to consider those arguments, however, we wish briefly to discuss some of the contentions advanced in the brief for petitioner in the *Sanford Estate* case with which we are not in entire agreement.

The first of these contentions is based on the decision in *Porter* v. *Commissioner, supra.* This Court there held that a transfer in trust in which the grantor reserved only a power of modification was subject to the estate tax by virtue of the specific provisions of Section 302 (d) of the Revenue Act of 1926 and stated that such a transfer would not be subject to tax under Section 302 (a) of the Act standing alone. The petitioner in the *Sanford Estate* case urges that Section 302 (a) of the estate tax law and Section 319 of the gift tax law (Revenue Act of 1924) are of the same scope and that the statement of the Court in the *Porter* case that a transfer of the type here involved does not come within the terms of Section 302 (a) is author-

ity that it does not come within the terms of Section 319. (Br. 49–51.)

We believe this contention to be unsound. The operation of Sections 302 (a) and 319 with respect to revocable trusts demonstrates that they are not intended to be correlative. As we have already pointed out, the surrender of a power of revocation constitutes a taxable gift within the meaning of Section 319 (*Burnet* v. *Guggenheim, supra*), whereas the termination of a similar power through the death of the grantor does not make the trust property subject to estate tax by virtue of Section 302 (a).[*] *Porter* v. *Commissioner, supra,* at 442. No property is included in the gross estate by virtue of that section except "To the extent of the interest therein of the decedent at the time of his death * * *." Hence that subdivision applies exclusively to property of which the decedent had beneficial ownership at the time of his death and not to property which at the time of his death simply passes from his control. *Cf. United States* v. *Field*, 255 U. S. 257. Clearly, therefore, as this Court has already decided in the *Porter* and *Guggenheim* cases, Section 302 (a) of the estate tax and Section

[*] Trust property subject to a power of revocation in the donor is included in the gross estate of the decedent under the provisions of Section 302 (d), and, before the enactment of that section, such trusts were taxable under Section 402 (c) of the Revenue Act of 1921 (c. 136, 42 Stat. 227) as transfers intended to take effect in possession or enjoyment at or after death. See *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339.

319 of the gift tax are not of the same scope and Section 319 cannot be construed in the light of Section 302 (a).

In arguing otherwise, the petitioner cites *Curry* v. *McCanless* and *Graves* v. *Elliott*, both of which cases were decided by this Court on May 29, 1939, Nos. 339 and 372, respectively, October Term, 1938. Neither of those cases involved the construction of a federal statute. Both concerned the constitutionality of state transfer taxes, and it was with reference to the question of constitutional power that this Court stated in the *Curry* case that a general testamentary power of appointment is to be regarded as equivalent to ownership of the property subject to the power, and that in the *Elliott* case it compared a power of revocation to a power of appointment.

We are also in disagreement with the contention of the petitioner in the *Sanford Estate* case that the decision in *Hesslein* v. *Hoey* is not entitled to much weight because the case was decided on a motion to dismiss the complaint and because the court did not have before it the carefully considered rulings made by the Treasury Department in the *Sanford Estate* case, nor any information concerning the practice of the Bureau of Internal Revenue in dealing with similar cases, nor the legislative history of the Revenue Act of 1924 (Br. 12.)

For reasons already stated, there is ground for believing that *Hesslein* v. *Hoey* may have been incorrectly decided, but we do not believe the as-

sumption is justified that the court did not give thorough consideration to the question before it. The record was entirely adequate to present the issue and the question of law was fully briefed and argued. It does not appear from the opinion in the case that the legislative history of the tax was disregarded by the court or ignored in the briefs. We fail to see how any significance can be attached to the fact that the court did not have before it the then unpublished rulings in the *Sanford Estate* case, one of which, as a matter of fact, was in accord with the rule adopted in the *Hesslein* case. Cf. *Helvering* v. *N. Y. Trust Co.*, 292 U. S. 455. Nor do we believe that a fuller knowledge of what the Bureau practice had been would have affected the court's conclusion since the court construed the applicable Treasury regulation as contrary to its decision and expressly disregarded it.

Finally, while we share the solicitude of the petitioner in the *Sanford Estate* case that there be no adverse effect on federal revenues, we cannot agree that a decision that the tax attaches only upon relinquishment of the power of modification would permit "flagrant and widespread income tax avoidance." (Br. 30.) The income tax law was in effect long prior to the enactment of the gift tax. No construction of the gift tax, therefore, could open any avenue to income tax avoidance; at most, it could only fail to close such an avenue. It is reasonable to assume that if Congress thought that a grantor could relieve himself of income tax lia-

bility by creating a trust with a reserved power of modification, and if it had intended to guard against such avoidance, it would have done so directly by taxing the income from such a trust to the grantor,[9] rather than indirectly by imposing a gift tax upon creation of the trust.

Nor do we believe that a decision in favor of the Government in the *Sanford Estate* case and against the Government in the *Humphreys* case would have any predictably adverse effect upon federal revenues. Petitioner's argument (Br. 30 *et seq.*) is that, if the tax is imposed upon the creation of a trust subject to a reserved power of modification, it would act as a deterrent upon transfers in trust and thereby increase income tax revenues, whereas a tax imposed only when the power of modification is relinquished would not be such a deterrent. The argument is premised on the assumption that, if threatened by the immediate imposition of a gift tax, the would-be donor would decide not to make the transfer at all and would remain taxable on the income of his property, while the prospect of a gift tax in the future (which he could avoid by not surrendering the reserved power to modify) or the

[9] No useful purpose would be served by entering into a discussion of petitioner's contention, based on *Knapp* v. *Hoey*, 104 F. (2d) 99 (C. C. A. 2d), that such an income tax would be beyond the power of Congress. Even were this so, it would not throw any light upon the intention of Congress, since there is no indication whatever that Congress believed that it was without the power to levy such a tax and that, for this reason, it enacted the gift tax as a deterrent to the creation of the type of trusts here involved.

imposition of an estate tax upon his death would not have such a result. But there are reasons why it cannot be assumed that this would be the reaction of the would-be donor. He might decide to create a trust in which he reserved no power of modification or revocation and thus avoid both estate and income taxes, the saving in which might well be greater than the amount of the gift tax which he would have to pay. The gift tax rates are considerably lower than the estate tax rates and the saving resulting from the payment of the lower of the two transfer taxes, in conjunction with the saving on income taxes, might well induce the donor to create an irrevocable trust with no power of modification reserved, rather than to make no transfer of the property whatever.

Under these circumstances, we believe that any prediction as to the effect upon federal revenues of a decision either way in the present cases is too hazardous to form the basis of any justifiable inference as to the probable intention of Congress in enacting the gift tax law.

II

THE ARGUMENTS IN SUPPORT OF THE GOVERNMENT'S POSITION IN THE SANFORD ESTATE CASE THAT A TRANSFER IN TRUST IS NOT A COMPLETED GIFT SO LONG AS THE DONOR RESERVES POWER TO MODIFY THE TRUST DEED AND CHANGE THE BENEFICIARIES

However strong the argument that there is a completed gift *from the donor* when he divests himself of all beneficial interest in the trust property,

it nevertheless cannot be denied that the term "gift," as it is commonly understood, connotes a transfer without consideration from a donor to specific donees. See *Hesslein* v. *Hoey, supra.* A transfer of property in trust for persons who may any moment be deprived of all benefit from the property is not a real and substantial gift to anyone; the rights of the named beneficiaries are purely formal. There is strong ground for believing, therefore, that Congress intended to impose the tax only when the power of modification is relinquished since only then is there a completed gift to any particular donee or donees.[10]

It is not an answer to this argument to suggest that for this purpose the trustee is the donee. If that were true, the tax could be imposed upon a transfer in trust for the benefit of the donor. *Burnet* v. *Guggenheim, supra,* indicates that this is not the law. Clearly, therefore, the trustee is not to be regarded as the donee for the purpose of determining when there has been a completed gift.

Nor is it a satisfactory reply to this argument to suggest that if the tax is to await the irrevocable designation of donees, no tax can be imposed where

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[10] This Court in *Helvering* v. *City Bank Co.*, 296 U. S. 85, indicated that it did not consider a transfer in trust subject to a reserved power of modification in the grantor alone to be complete. This is apparent from the fact that it construed the decision in *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339, as holding that such a transfer in trust may be taxed, upon the grantor's death, as intended to take effect in possession or enjoyment at or after his death.

the trust is not subject to any power of modification but the remaindermen are unascertained persons. In such a case the grantor has fully exercised his power to choose beneficiaries by designating the class of persons who are to take the property, even though the ultimate beneficiaries may not be known until certain events have occurred which are beyond the grantor's power to control. The gift to those ultimate beneficiaries is as complete as the donor can presently make it. In a case like those at bar, on the other hand, the grantor has not fully exercised his power to choose the beneficiaries. As the court suggested in the *Hesslein* case, the day after creating the trust the grantor might have changed it so as to provide that both income and principal should go to a charity instead of to the designated donees.

Moreover, it may plausibly be argued not only that there is not a completed gift to any particular donees but also that there is not a completed gift from the donor. While the donor has, it is true, made a complete transfer of all his property rights in the trust estate, the control which he has retained over the ultimate disposition of the estate is susceptible of such exercise as to afford him considerable indirect economic benefit from the property. It is not unreasonable to assume that the named beneficiaries or prospective donees would be influenced to act in accordance with the donor's wishes in order to prevent or induce, as the case might be, an exercise of the donor's reserved

power. Because of this, the reserved power gives the donor an interest in the trust estate, which, in its effect, is closely akin to a property right. Until this interest is transferred by relinquishment of the reserved power, the transfer of the trust property may logically be deemed an imperfect gift.

Porter v. *Commissioner, supra,* lends support to this view. As previously stated, this Court there held that property transferred by a decedent in trust with a reserved power to change the beneficiaries was properly included in the gross estate of the decedent for purposes of the estate tax. The significance of the decision for present purposes does not lie in the fact that the Court held that the transfer came within the provisions of Section 302 (d) of the Revenue Act but in the fact that it held the statute constitutional as applied to trusts created before there was any provision in the estate tax law subjecting them to the tax. If the transfers by the donor had been deemed complete when made, the statute could not have been applied to them retroactively. *Helvering* v. *Helmholz,* 296 U. S. 93. But the Court held that they were incomplete, stating (288 U. S. at 444):

> They treat as without significance the power the donor reserved unto himself alone and ground all their arguments upon the fact that deceased, prior to such enactment, completely divested himself of title without power of revocation. It is true that the power reserved was not absolute as in the

> transfer considered in *Burnet* v. *Guggenheim, supra,* in which this court, in the absence of any provision corresponding to subdivision (d), held that the donor's termination of the power amounted to a transfer by gift within the meaning of § 319 of the Revenue Act of 1924, 43 Stat. 313. But the reservation here may not be ignored, for, while subject to the specified limitation, it made the settlor dominant in respect of other dispositions of both corpus and income. His death terminated that control, ended the possibility of any change by him, and was, in respect of title to the property in question, the source of valuable assurance passing from the dead to the living. That is the event on which Congress based the inclusion of property so transferred in the gross estate as a step in the calculation to ascertain the amount of what in § 301 is called the net estate. * * *

Burnet v. *Guggenheim, supra,* insofar as it indicates that the gift and estate taxes are *in pari materia,* also supports the view that imposition of the tax must await relinquishment of the power of modification. This Court there stated (288 U. S. at 286–287):

> The tax upon gifts is closely related both in structure and in purpose to the tax upon those transfers that take effect at death. What is paid upon the one is in certain circumstances a credit to be applied in reduction of what will be due upon the other, 43 Stat. 315, § 322, 26 U. S. C., § 1134. The

gift tax is Part II of Title III of the Revenue Act of 1924; the Estate Tax is Part I of the same title. The two statutes are plainly *in pari materia.* There has been a steady widening of the concept of a transfer for the purpose of taxation under the provisions of Part I. *Tyler* v. *United States, supra; Chase National Bank* v. *United States, supra; Saltonstall* v. *Saltonstall, supra;* cf. *Bullen* v. *Wisconsin,* 240 U. S. 625. There is little likelihood that the lawmakers meant to narrow the concept, and to revert to a construction that would exalt the form above the substance, in fixing the scope of a transfer for the purposes of Part II. We do not ignore differences in precision of definition between the one part and the other. They cannot obscure identities more fundamental and important. The tax upon estates, as it stood in 1924, was the outcome of a long process of evolution; it had been refined and perfected by decisions and amendments almost without number. The tax on gifts was something new. Even so, the concept of a transfer, so painfully developed in respect of taxes on estates, was not flung aside and scouted in laying this new burden upon transfers during life. Congress was aware that what was of the essence of a transfer had come to be identified more nearly with a change of economic benefits than with technicalities of title. The word had gained a new color, the result, no doubt in part, of repeated changes of the statutes, but a new color none the less. Cf. *Towne* v.

Eisner, 245 U. S. 418, 425; *International Stevedoring Co.* v. *Haverty*, 272 U. S. 50; *Gooch* v. *Oregon Short Line R. Co.*, 258 U. S. 22, 24; *Hawks* v. *Hamill*, *ante*, 52, 57.

The foregoing language unquestionably contains an indication that the test of whether the relinquishment of a reserved power is taxable as a gift is whether the termination of such a power upon death is taxable under the estate tax law. If this be so, decision must be in favor of the Government in the *Sanford Estate* case and in favor of the taxpayer in the *Humphreys case*, since the termination by death of a power of modification makes the trust property part of the gross estate for estate tax purposes. *Porter* v. *Commissioner*, *supra*.

This reasoning, as we have pointed out above, was the principal basis of the decision by the Circuit Court of Appeals for the Second Circuit in *Hesslein* v. *Hoey*, *supra*. The court there stated (p. 956):

> Since the primary purpose of the gift tax statute is to supplement the estate tax statute, it is reasonable to construe the former as excluding gifts so incomplete by reason of powers reserved to the donor, as to be expressly made subject by the latter to the estate tax.

The legislative history of the gift tax confirms the view expressed in the *Guggenheim* and *Hesslein* cases that the gift tax was designed as a complement to the estate tax, although there is no conclusive indication that the gift tax was intended to be construed in the light of the estate tax. The

gift tax provisions of the Revenue Act of 1924 were added by amendments to the revenue bill introduced on the floor of the House and the Senate. See Cong. Rec., Vol. 65, Part 3, pp. 3118–3119; Part 4, pp. 3170–3171; Part 8, p. 8094. The sponsor of the amendment in the House remarked that the gift tax was "a corollary to an estate tax," and, in answer to a question whether the donor or donee would pay the tax, stated that the donor was responsible under the amendment because it was drawn to correspond with the estate tax. Cong. Rec., Vol. 65, Part 3, pp. 3119–3120. He added, however, that the amendment was also needed to protect income tax revenues since the splitting up of large estates reduced the amount of surtaxes as well as defeating the estate tax. Cong. Rec., Vol. 65, Part 3, p. 3120; Part 4, p. 3172. Representative Garner of Texas stated that the principal purpose of the gift tax was to be a "mother tax" to the estate tax. Cong. Rec., Vol. 65, Part 3, p. 3122. The remarks of the sponsor of the amendment in the Senate were similar to those made by the sponsor of the amendment in the House. Cong. Rec., Vol. 65, Part 8, pp. 8095–8096.

When the gift tax provisions of the 1924 Act were repealed in 1926, the Senate Report stated that the tax had been adopted as correlative to the estate tax and that it was being repealed because it involved numerous administrative difficulties, the revenue derived from it was small, and it was easily evaded. S. Rep. No. 52, 69th Cong., 1st Sess.,

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p. 9. It is plausible to assume that its repeal was also linked with the enactment of Section 302 (c) of the Revenue Act of 1926 (U. S. C., Title 26, Sec. 411) which changed the existing estate tax law by creating a conclusive presumption that gifts made within two years prior to the decedent's death were made in contemplation of death. The Revenue Act of 1932 revived the gift tax shortly after the provision for this conclusive presumption was held unconstitutional in *Heiner* v. *Donnan*, 285 U. S. 312, decided March 21, 1932. See *Hesslein* v. *Hoey, supra.*

The reports of the House and Senate committees on the 1932 Act, like the statements made on the floor of Congress during the debates on the 1924 Act, demonstrate an intention to correlate the two transfer taxes. The report of the House Ways and Means Committee was, in part, as follows (H. Rep. No. 708, 72d Cong., 1st Sess., pp. 8, 28–29):

> To assist in the collection of the income and estate taxes, and prevent their avoidance through the splitting up of estates during the lifetime of a taxpayer, your committee recommends a gift tax with a maximum rate of 30 per cent. The increased estate tax and the gift tax together will produce additional revenue for the fiscal year 1933 of only $35,000,000.
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> * * * * *
>
> In short, the design is to impose a tax which measurably approaches the estate tax which would have been payable on the donor's

death had the gifts not been made and the property given had constituted his estate at his death. The tax will reach gifts not reached, for one reason or another, by the estate tax.

The gift tax will supplement both the estate tax and the income tax. It will tend to reduce the incentive to make gifts in order that distribution of future income from the donated property may be to a number of persons with the result that the taxes imposed by the higher brackets of the income tax law are avoided. It will also tend to discourage transfers for the purpose of avoiding the estate tax.

* * * Since the gift tax is an adjunct of the estate tax which is not restricted to transfers made within a single year, an effective gift tax must give consideration, so far as the rate of tax is concerned, to transfers made in prior years.

* * * * *

The report of the Senate Finance Committee contains substantially the same statements (S. Rep. No. 665, 72d Cong., 1st Sess., pp. 11, 40), and the same views were also expressed during the debates on the bill in Congress (Cong. Rec., Vol. 75, Part 5, pp. 5688–5691).

If, as this legislative history indicates, the gift tax was designed as a complement to the estate tax, it would seem proper to interpret the gift tax as intended to impose liability only upon relinquishment of the grantor's power of modification.

If the gift tax is imposed at a time when the grantor still retains a power of modification, and if he fails to exercise it, an estate tax will also be imposed. While this creates no problem of double taxation because the gift tax is allowed as a credit against the estate tax (*supra*, p. 30), it clearly fails to correlate the two transfer taxes.

It is true, as pointed out in the first portion of this brief, that Section 302 (d) of the estate tax contains a specific provision for taxation of the termination by death of a reserved power of modification, while the gift tax contains no similar provision. But in the *Guggenheim* case, this Court rejected the contention that the concept of a transfer under the gift tax law differs from that under the estate tax law simply because the former fails to specify as taxable gifts transfers expressly subjected to the estate tax under Section 302 (d). While the difference in the precision of definition between the two laws may not be ignored, no canon of statutory construction compels the conclusion that the two laws are different in scope because different in the particularity with which the objects of taxation are specified.

The correlation argument is bolstered by consideration of Section 510 of the gift tax law which imposes a secondary liability upon the donees for payment of the tax. If imposition of the tax at the creation of the trust means that the named beneficiaries are secondarily liable for the tax under Section 510 even though they may subse-

quently be deprived of all interest in the property, an incongruous situation would be created. Although, as we have pointed out in the first section of this brief, this construction of Section 510 is by no means free from doubt, it was the construction adopted by the Circuit Court of Appeals for the Second Circuit in the *Hesslein* case. Moreover, as the court pointed out in the *Hesslein* case, if a gift tax is imposed on a transfer in trust before the donor has irrevocably chosen the beneficiaries, it would result in imposing a tax upon a charitable gift if the donor should ultimately decide to change the named beneficiaries and substitute a charity. Congress clearly did not intend gifts to charity to be so reduced since it expressly exempted them from the gift tax. Section 505 (a) of the Revenue Act of 1932, U. S. C., Title 26, Section 554.

In deciding the *Hesslein* case, the court disregarded the Treasury Regulations, which it construed as being opposed to its decision, on the ground that they were of recent adoption and did not have the sanction which would result from a subsequent reenactment of the statute. We have pointed out in the first portion of this brief that there are considerations which indicate that the court may have erred in this respect. On the other hand, it is unquestionably true that the earlier regulations, which are the ones applicable to the cases at bar, cover the present situation, if at all, only by implication. They are addressed specifically to the exercise of a power of revocation and

may well not have been intended to include the case of a reservation of a power of modification. As we have pointed out above, the Circuit Court of Appeals for the Third Circuit, in its opinion in the *Sanford Estate* case, expressed the view that the regulations were inconclusive.

CONCLUSION

We believe that almost equally cogent arguments may be advanced in support of the position which the Government has taken in each of the cases at bar and we do not feel that a decision either way will have any predictable effect upon the aggregate amount of federal revenues.

Respectfully submitted.

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SEPTEMBER 1939.

APPENDIX

Revenue Act of 1924, c. 234, 43 Stat. 253:

SEC. 319. For the calendar year 1924 and each calendar year thereafter, a tax equal to the sum of the following is hereby imposed upon the transfer by a resident by gift during such calendar year of any property wherever situated, whether made directly or indirectly, and upon the transfer by a nonresident by gift during such calendar year of any property situated within the United States, whether made directly or indirectly:

* * * * *

SEC. 320. If the gift is made in property, the fair market value thereof at the date of the gift shall be considered the amount of the gift. Where property is sold or exchanged for less than a fair consideration in money or money's worth, then the amount by which the fair market value of the property exceeded the consideration received shall, for the purpose of the tax imposed by section 319, be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

SEC. 323. Any person who within the year 1924 or any calendar year thereafter makes any gift or gifts in excess of the deductions allowed by section 321 shall, on or before the 15th day of March, file with the collector a return under oath in duplicate, listing and setting forth therein all gifts and contributions made by him during such calendar year (other than the gifts specified in paragraph (3) of subdivision (a) and in paragraph

(2) of subdivision (b) of section 321), and the fair market value thereof when made, and also all sales and exchanges of property owned by him made within such year for less than a fair consideration in money or money's worth, stating therein the fair market value of the property so sold or exchanged and that of the consideration received by him, both as of the date of such sale or exchange.

SEC. 324. The tax imposed by section 319 shall be paid by the donor on or before the 15th day of March, and shall be assessed, collected, and paid in the same manner and subject, insofar as applicable, to the same provisions of law as the tax imposed by section 301.

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 501. IMPOSITION OF TAX.

(a) For the calendar year 1932 and each calendar year thereafter a tax, computed as provided in section 502, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.

(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but, in the case of a nonresident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States. The tax shall not apply to a transfer made on or before the date of the enactment of this Act.

(c) The tax shall not apply to a transfer of property in trust where the power to revest in the donor title to such property is vested in the donor, either alone or in con-

junction with any person not having a substantial adverse interest in the disposition of such property or the income therefrom, but the relinquishment or termination of such power (other than by the donor's death) shall be considered to be a transfer by the donor by gift of the property subject to such power, and any payment of the income therefrom to a beneficiary other than the donor shall be considered to be a transfer by the donor of such income by gift. [U. S. C., Title 26, Sec. 550.]

SEC. 506. GIFTS MADE IN PROPERTY.

If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift. [U. S. C., Title 26, Sec. 555.]

SEC. 509. PAYMENT OF TAX.

(a) *Time of Payment.*—The tax imposed by this title shall be paid by the donor on or before the 15th day of March following the close of the calendar year.

* * * * *

[U. S. C., Title 26, Sec. 558.]

SEC. 510. LIEN FOR TAX.

The tax imposed by this title shall be a lien upon all gifts made during the calendar year, for ten years from the time the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift. Any part of the property comprised in the gift sold by the donee to a bona fide purchaser for an adequate and full consideration in money or money's worth shall be divested of the lien herein imposed and the lien, to the extent of the value of such gift, shall attach to all the property of the donee (including after-acquired property)

except any part sold to a bona fide purchaser for an adequate and full consideration in money or money's worth. If the Commissioner is satisfied that the tax liability has been fully discharged or provided for, he may, under regulations prescribed by him with the approval of the Secretary, issue his certificate, releasing any or all of the property from the lien herein imposed. [U. S. C., Title 26, Sec. 559.]

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 511. GIFTS OF PROPERTY SUBJECT TO POWER.

Subsection (c) of section 501 of the Revenue Act of 1932 (relating to the inapplicability of gift tax in the case of the transfer of property in trust subject to the power of the donor to revest title in himself) is repealed. [U. S. C., Title 26, Sec. 550.]

Treasury Regulations 67 (1924 ed.), promulgated under the Revenue Act of 1924:

ARTICLE 1. *Tranfers reached.*—At common law the term "gift" is applied only to voluntary transfers of property made without consideration or compensation therefor. But the taxing act with which these regulations deal employs the term "gift" in a wider and more comprehensive sense, for, while it embraces transactions which at common law amount to gifts, it goes further by including sales and exchanges for less than a fair consideration in money or money's worth. (See sec. 320.) Hence, the statute reaches and taxes all transfers of property made during the calendar year (other than the gifts specified in par. (3) of subdivision (a) and in par. (2) of subdivision (b) of sec. 321), to the extent that they are dona-

tive in character and exceed the authorized deductions.

The subject of the gift may consist of any species of property or interest therein, whether legal or equitable. Thus, for example, a taxable transfer may be effected by a transfer of real estate, by the declaration of a trust, by the forgiveness of an indebtedness, the payment of another's debt, the assignment of a judgment, or the transfer of cash, certificates of deposit, or of Federal, State, or municipal bonds. A sale or exchange for a consideration reducible to a money value which is less than a fair consideration amounts to a gift, within the meaning of the statute, to the extent that the fair market value of the property, at the time of the transfer, exceeds the consideration received. If the consideration is not reducible to a money value it is to be wholly disregarded. A transfer which is neither a sale nor an exchange does not involve a gift if there is a valid, even if not an adequate, consideration for the transfer.

The creation of a trust, where the grantor retains the power to revest in himself title to the corpus of the trust, does not constitute a gift subject to tax, but the annual income of the trust which is paid over to the beneficiaries shall be treated as a taxable gift for the year in which so paid. Where the power retained by the grantor to revest in himself title to the corpus is not exercised a taxable transfer will be treated as taking place in the year in which such power is terminated.

The statute embraces donative transfers made by corporations, associations, partnerships, trusts, and estates, as well as those made by individuals. (See art. 25.)

Treasury Regulations 79 (1933 ed.), promulgated under the Revenue Act of 1932:

ART. 3. *Transfers in trust.*—Where property is transferred in trust without an adequate and full consideration in money or money's worth and without the reservation of the power to revest in the donor title to such property, the transfer is a gift, but, where the donor reserves such power, the transfer does not constitute a gift within the meaning of the statute. The relinquishment or termination, without an adequate and full consideration in money or money's worth, of the power to revest in the donor title to property transferred in trust, is a gift of such property at the time of the relinquishment or termination of the power, except where the power is terminated by the donor's death. The payment of income to a beneficiary of a trust, other than the donor, is a gift of such income where the donor has the power to revest in himself title to the trust property. For the purposes of these regulations a donor shall be considered as having the power to revest in himself title to the property transferred in trust where he has such power in conjunction with any person not having a substantial adverse interest in the disposition of the trust property or the income therefrom. A trustee, as such, is not a person having a substantial adverse interest in the disposition of the trust property or the income therefrom. Where the power to revest in the donor title to property transferred in trust reposes in him in conjunction with any other person having a substantial adverse interest in the disposition of the property or the income therefrom or where the power is in such other person alone, the transfer is subject to tax as though no such power existed.

Treasury Regulations 79 (1936 ed.), promulgated under the Revenue Act of 1932 as amended by the Revenue Acts of 1934 and 1935:

> ART. 3. *Cessation of donor's dominion and control.*—The tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable.
>
> As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to cause the beneficial title to be revested in himself, the gift is complete. But a transfer (in trust or otherwise), though passing both legal and beneficial title, is still in essence merely formal so long there remains in the donor a power to cause the revesting of the beneficial title in himself, and the gift, from the standpoint of substance, remains incomplete during the existence of the power. A donor shall be considered as having the power to revest in himself the beneficial title to the property transferred if he has such power in conjunction with any person not having a substantial adverse interest in the disposition of the property or the income therefrom. A trustee, as such, is not a person having a substantial adverse interest in the disposition of the trust property or the income therefrom. The relinquishment or termination of the power, occurring otherwise than by the death

of the donor (the statute being confined to transfers by living donors), is regarded as the event which completes the gift and causes the tax to apply.[1] The receipt of income or of other enjoyment of the transferred property by the transferee or by the beneficiary (other than by the donor himself) during the interim between the making of the formal transfer and the relinquishment or termination of the power operates to free such income or other enjoyment from the donor's power to receive it himself, and constitutes a gift of such income or of such other enjoyment taxable in the calendar year of its receipt.

If the donor contends that a power retained by him constitutes beneficial dominion and control, and that by reason thereof the transfer is not in substance a gift, the transaction shall be disclosed in the return and evidence showing all relevant facts, including a copy of the instrument by which the transfer was made, should be submitted.

[1] So held in *Burnet* v. *Guggenheim* (288 U. S. 280, 53 S. Ct. 369) of a transfer in trust, made in 1917, with power in the donor to revoke, which power he relinquished in 1925, the relinquishment being treated a gift subject to the tax imposed by the gift tax title of the Revenue Act of 1924.

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